Mrs. Thatcher

Confidential

TO ALL MEMBERS OF THE SHADOW CABINET

The attached paper, prepared by the Economics Section, sets out some of the main options which would seem to be open to the Government in deciding the contents of its economic package and comments briefly on these. It is hoped that this will be useful background material to Members of the Shadow Cabinet in the context of the forthcoming White Paper.

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Detailed Policy Options

This paper looks at some of the main policy options which the Government would seem to have open to it in carrying through the measures outlined by Mr Healey on 1st July. Brief comments on the options are made in the right-hand column.

Controls on Pay

Indications of policy already given

Mr Healey's statement, 1st July:- (Hansard Col.s 1189-90)

"We are determined to bring the rate of domestic inflation down to 10 per cent by the end of the next pay round and to single figures by the end of 1976. This means the increase in wages and salaries during the next pay round cannot exceed 10 per cent. The same limit is being set for dividends.

...(these measures) will set out how the 10 per cent limit for settlements should be expressed; for example as a percentage or flat rate or some mixture of the two ...They will deal with the central problem of compliance, since it is no good having an agreed limit for pay increases unless we can be certain it will not be exceeded. In particular, we must be able to satisfy those who settle early in the round that they will not be left behind by later settlements at an excessive level.

...The Government will use a battery of weapons for this purpose...we propose to fix cash limits for wage bills in the public sector...We shall take action through the Price Code to encourage compliance by private employers. ...If...no agreement can be reached which meets these conditions ('convincing arrangements for ensuring compliance') the Government will be obliged to legislate to impose a legal requirement on both public and private sector employers to comply with the 10 per cent limit.

...The easiest way of securing a differential advantage for those in areas of below-average wages would be to adopt a form of limit based on a cash sum rather than a percentage.

...I think that some caution is needed in the application of the Price Code to ensure that firms are not sent bankrupt, with people being thrown out of work, by too stringent an application..." (Col. 1197)

Small firms In reply to a question (3rd July Col. 1671) asking for assurance that large and small firms would not be forced to choose between breach of controls and strikes in support of excessive claims, Mr Wilson said:

..."There is no question of making small firms the whipping boys of the policy..."

<u>Sanction against workers</u> * Mr Wilson: "We reject, as we always have rejected, the idea of statutory policies based on criminal sanctions against workers who...went on strike for higher wages than the nation could afford. We may need a reserve power. It will take the form of a power directed against a recalcitrant employer". - speech at Brecon, 6th July (Sunday Times report)

<u>Special Cases</u> Mr Wilson said in the House of Commons on 3rd July:

> "The Government are anxious that, in applying the limits on incomes for the coming year...announced on Tuesday, we shall be able to take decisions about anomalies in respect of awards in industry generally including hangover cases from the last pay round and arbitration decisions which have been made or are already proceeding. The transitional arrangements which we must announce in the next few days will be very important, and we certainly want to consider how they should be assimilated to the report of the review body dealing with Members' pay and allowances" (Col. 1672)

<u>Options</u>	<u>Comment</u>
1. <u>Form of pay limit</u>	
(a) Flat rate in cash terms - rumoured to be £6.	Benefits the low paid; probably greater appearance of fairness than any other form of limit; to the extent that the sum covers cost of increases in basic necessities - food, fuel, fares - it can be argued that it safeguards a basic standard of living, and in present circumstances it is not possible to safeguard higher standards. <u>But</u> the erosion of differentials is likely to lead to strong pressure for their restoration when the control is lifted, and this could trigger a fresh pay explosion. <u>Advantage</u>: simplicity and minimum scope for 'fiddling'; and relatively easy to police.
(b) Percentage rate increase - 10 per cent	Benefits most the high-paid worker - £80-100 a week; low paid and very high paid lose. Refinements to overcome this disadvantage - such as a higher percentage increase up to certain income levels, tapering off thereafter - would increase the complications. Problems of definition - percentage of what? basic rates? average annual earnings? give scope for disputes and evasion, requiring elaborate policing.

* Please see Appendix

(b)	Other cases - where no price increase is involved.	Obvious unfairness of firms able to absorb wage increases because of lower raw material costs pay increases above the limit. This suggests either that prior approval should be required for any wage increase or that all increases should be subject to spot checks.
(c)	Firms and awards to be covered.	Mr Wilson's reference to small firms not being made whipping boys, (3rd July) may suggest that only large firms/awards involving large numbers are to be subject to control and/or reporting (as under Counter Inflation Stages I, II and III).
(d)	Imposition of fiscal sanctions and fines.	Who is to impose/enforce penalties - such as the proposed tax on employers exceeding the limit? Under the 1966-68 legislation the Prices and Incomes Board made recommendations only; orders enforcing controls were made by the Secretary of State. Under the Counter Inflation Acts orders were made by the Pay Board and Price Commission. If Inland Revenue were required to administer tax increases on 'rogue elephants' all the problems involved in selective taxation would arise.
(e)	Control on employers/ unions.	Mr Wilson has foresworn 'criminal sanctions' against workers. This would presumably not rule out requiring unions to furnish information on pay claims or awards, provided that penalties for paying in excess were confined to employers - with possible variations on the previous system of prior vetting of claims by the TUC. There could be scope for pressure to conform from other unions - if TUC agreement is obtained.
(f)	Information	It is possible that the Government will seek to require firms (or unions) to provide more information on pay. The Price Commission already deals with this on prices. What if any new body might be required to deal with pay? Alternatively, the Department of Employment or the Manpower Commission might take on this function.
(g)	Protection for employers	Both the 1966 Prices and Incomes Act and the Counter Inflation Act gave protection for employers against claims for breach of contract arising from pay settlements which they were forbidden under the Acts to implement. If the Government propose to put the whole burden of restraint on employers, it will be even more necessary to give them protection against such claims.

3. Timing

(i) of introduction of controls	
(a) Immediate legislation	Likely to increase union opposition legislation could, as in 1966, contain reserve powers to be implemented by Order in Council only if required - e.g. after voluntary restraint had been breached.
(b) Voluntary system at present	With commitment to introduce legislation (possibly containing provision for back-dating) in the autumn. Unlikely to reassure creditors abroad.
(ii) Duration of controls	
(a) Control by stages	The absence of serious challenge to previous statutory controls (until the miners in 1974) may have been largely due to the short period of time involved - 6 months' severe restraint in 1966-67; 90 days' freeze, 6 months Stage II in 1972-73. It may not be worth while for a union to challenge the control if its end is clearly in sight - or modification likely in the near future. If unemployment reaches 1½ million or more by the end of this year, the risk of a wage explosion at the end of a short freeze or severe restraint with no exceptions may well be less than on previous occasions. But, for the policy to succeed clearly whatever controls are now introduced will have to cover a complete wage round, over a full year. It is rumoured that the Government intend them to extend for 2 years.

The Government's Options on Prices

The Chancellor's statement on 1st July indicated that the Government will amend its policy in two distinct respects:

(i) "We shall take action through the Price Code to ensure compliance (with a 10 per cent wage norm) by private employers".

(ii) There will be "action to check the rate of price increases as the rate of pay inflation slows".

The Chancellor added "I recognise that the Price Code has been bearing very heavily on many companies. It will not bear more heavily under the proposals I put forward except on companies which made settlements in excess of a level which I hope the Rt. Hon. Gentleman will endorse".

1. (i) Enforced Compliance with the 10 per cent norm

The Government's intention is almost certainly to amend the Code to ensure that companies conceding wage settlements in excess of 10 per cent will not be able to unload the bill on to higher prices. Such a provision will probably replace the existing "Productivity Deduction" which prohibits most companies from passing on more than 80 per cent of an increase in labour costs. It seems likely that the safeguards in the Code will not apply where a loss of profitability is specifically due to this new provision. The Government can change the Price Code by order. However, the Counter-Inflation Act from which such orders derive their force expires in March 1976.

(a) While the scheme might appear to be a way of stiffening the resolve of those companies too hard pressed to be able to absorb high labour costs, it is in fact nearly bankrupt companies who most often give into excessive wage demands because they cannot afford disrupted production.

(b) Trade unionists will only be deterred from demanding unrealistic wages if, as seems unlikely, they can be persuaded that a socialist administration will not take over firms which are pushed to the wall. If the Government lost its nerve in the face of soaring unemployment the policy could in fact lead to massive extension of state ownership. If the Government stood firm, the consequences would probably be the very unemployment which an incomes policy is supposed to avert.

(c) It is wrong to place the onus on the employer when the responsibility is the Government's.

(d) By further interference with companies' relative costs the scheme will intensify damaging distortions already caused by the existing "Productivity Deduction" and incur an even lower rate of return on capital employed.

(ii) The Government may also impose fiscal penalties or fines on companies who do not comply with the wage norm, (see page 4)

2. Action to Check Prices

The Chancellor's "action to check the rate of price increases as the rate of pay inflation slows" will probably, in view of his promise that such action will not impose additional and severe burdens on industry, not be very drastic. The Code's "allowable costs" provisions mean that at a time of falling labour costs there will be an automatic reduction in the size of permitted price increases. In addition the Chancellor might:

(i) Secure more effective enforcement of the existing Code. Paragraph 21 of the Code obliges companies to reduce their prices where an increase in costs which was used to justify a previous price rise has since been eliminated by, for instance, a fall in commodity prices. The Chancellor might take administrative steps to ensure that price cuts of this kind are enforced more swiftly and more extensively.

Our attitude to this must depend on whether or not we favour a relaxation of the Code.

(ii) Enforce further price regulation under section two of the Prices Act. The Government might seek to extend the number of items subject to statutory maximum prices. (At the present only subsidised foods are affected). The voluntary agreement with the retailers to hold down the prices of a list of popular items has just expired and the goods that were covered by this are the most likely candidates for control.

This is a policy which will necessitate either (i) more expensive subsidies, or (ii) higher prices on other goods in compensation. In both cases the effect would be a serious distortion of demand.

(iii) Agree a "Voluntary Charter" with the Food industry. The food industry is willing to give certain undertakings of varying degrees of vacuity, about profit levels, industrial relations and environmental considerations in return for a removal, or an easing of statutory controls. The Government may see some cosmetic value in this.

We would hardly be anxious to oppose a move towards less statutory coercion.

The Public Sector - Cash Ceilings

(i) Government commitment

Mr Healey said in the House of Commons on 1st July:

"We propose to fix cash limits for wage bills in the public sector so that all concerned may understand that the Government are not prepared to foot the bill for excessive settlements through subsidies or borrowing or by loading excess costs on the public through increases in prices and charges...I propose to employ the system of cash limits more as a means of controlling public expenditure in the short term".

(ii) General considerations on cash limits

The problem of applying cash constraints, whether cash limits for wage bills or the system more generally, are somewhat different depending on whether one is concerned with nationalised industries on the one hand or central and local government on the other. In the case of the former, a cash limit on wage bills is a way of presenting more clearly and in advance of wage negotiations what is available for pay increases. If, as the Government proposes, nationalised industries are not able to put up prices and wages, they are left with the alternative of cutting back on the numbers they employ should the cash limits be exceeded. But clearly such cash contraints do not avoid the basic question of whether a Government is prepared to stand up against the unions whose pay claims disregard the cash limits.

Whilst the same basic problem arises over cash limits when applied to central and local government, there are a number of important subsidiary questions which can also be noted.

- Will cash limits include a forecast for the relative price effect. To the extent that they do, the cash ceiling would only be a limited check on expenditure? However, if the RPE is excluded then severe distortions could occur in public spending judged in volume terms. No Government could rely entirely on cash limits.

- How will cash limits be combined with the traditional methods of assessing civil service pay (Pay Research)? One can imagine circumstances in which there could be a conflict between the findings of Pay Research and the Government's cash ceiling.

- What additional mechanisms for controlling public expenditure will be needed by the Government in order to apply a system of cash limits? Existing procedures will almost certainly need to be strengthened, particularly as regards weak government.

- Does the Government's longer-term commitment to employ more generally a system of cash limits meas that more easily comprehensive statistical material on public expenditure will be published? Again this would seem very necessary.

Employment

Temporary Employment

The White paper could give some further details on the proposed temporary employment subsidy. The possibility of introducing special payments to firms which deferred planned redundancies was mentioned by Mr Healey in his April Budget speech. He said at the time that though this was not a measure called for by the existing circumstances, the Government would put itself in a position of being able to use temporary employment subsidies by an amendment to the Employment Protection Bill. This amendment has yet to be tabled.

The Party would want to inspect very carefully any precise measures to ensure that they filled the commitment given by the Chancellor of the Exchequer in his Budget speech that: "there would be no question of using such a scheme to encourage overmanning, or to prop up firms which would be incapable of standing on their own feet during normal times" (Hansard, 15th April, Col. 296). The difficulties of devising a workable scheme that avoided these dangers are considerable.

Work Creation Schemes	
The Manpower Services Commission is reported to have asked for funds to mount work creation schemes providing temporary community jobs in areas of high unemployment. This would be particularly helpful for the large number of school leavers now coming on to the labour market.	In recent weeks we have been calling on the Government to take more seriously the threat to the employment prospects of school leavers. We should therefore be prepared to give general support to any sensible measures that the Government has to propose in this area.
Increased provision for training and re-training facilities	
The Government provided an additional £50 million to the Manpower Services Commission over the next two years in the April budget.	Though there is a strong case for further Government help, the need to restrain public expenditure is likely to prevent further action.

Other Aspects of Policy

Credit Squeeze	
- raising interest rates	Government does not want to raise costs for industries and homebuyers, but the pound may force some rise in rates.
- special deposits	Most unlikely: Bank of England is (incredibly) worried that the money supply is expanding too slowly. It is difficult for us to oppose restraint, but we should criticise a squeeze on industry when the squeeze ought to be on the Government.
- lending ceilings and direct controls.	ditto
- changes in reserve asset rules	Several technical changes are required, but are unlikely to be made now. We should support them if they help the Bank of England run a 'sound money' policy.
Selective Credit Controls	
- generally in favour of (e.g.) manufacturing industry.	Both of these would involve yet further interference in the market mechanism by Government and would be repugnant to us for this reason.

- in favour of firms who obey wage norm and against those who break it.	A further point is that if the Government can cut off supply of credit, through the private banks, to firms of which they disapprove the next step will be to cut to individuals of whom they disapprove.

Import Controls

1. Comprehensive import controls, including such schemes as import deposits. 2. Selective import controls, applying to one section of industry, as for example, the textile industry.	The Prime Minister and other Ministers are on record as opposing import controls as harmful to the country's economic interests, apart from selective import controls which "may be necessary and which we are ready to introduce where there is clear evidence of dumping or unfair priactices", Hansard 26th June, Col. 664. In the unlikely event of the Government introducing import controls we shall want to opposed them strongly - for the reasons that they themselves have given in the past and because of the dangers of provoking a retreat into a siege economy.

Increase in the REP. Though the Government doubled REP last July, a further increase is an option they might consider attractive in order to help the regions.	Adverse public spending implications.
Increase in investment intentions to counteract decline in investment	Adverse public spending implications. Would do little to restore confidence so lacking, if the outcome of the battle against inflation is undecided and nationalisation remains Government policy.

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APPENDIX

Enforcement, offences and penalties under previous legislation

1. Mr Wilson is reported to have said: "We reject, as we always have rejected, the idea of statutory policies based on criminal sanctions against workers who went on strike for higher wages ..." (Sunday Times, 6th July 1975)

The Prices and Incomes Act 1966, however, made it an offence to pay an increase, or raise a price or charge, to which a standstill order had been applied by the Secretary of State.

The penalty on summary conviction, for either employee or trade union or other person, was a price not exceeding one hundred pounds; or £500 on indictment.

A trade union or other person was liable to similar penalties for taking or threatening to take "any action, and in particular any action by way of taking part, or persuading others to take part, in a strike, with a view to compel, induce or influence any employer to implement an award or settlement in respect of employment at a time when the implementation of that award or settlement is forbidden" under this Act.

Under Section 22 of the Act a trade union or employer's organisation was to be treated, for the purposes of enforcement of the Act, as though it were a corporate body.

2. Counter Inflation Act 1973 had similar provision, for prices of up to £400 on summary conviction, and of unlimited amount on endictment for contravening pay or price controls, or for failing to furnish information, or giving false information.

'An organisation of workers, or any other organisation or other person' who exerted pressure on an employer to contravene an order postponing a pay increase until the Pay Board had reported, or an order from the Board restricting the remuneration, or who called, organised, procured or financed a strike or industrial action short of a strike was liable to similar fines.

Mr Macmillan made clear, however, that an official of a trade union or organisation of workers active within the authority of his union would not personally be liable. It was only in the very last resort, when a fine had been imposed on an individual acting without his organisation's authority, and it had been impossible to collect the fine by attachment of earnings or distraint of goods, that a committal order could be made against him. As the Sunday Times commented at the time "The Government has made it virtually impossible for any new industrial 'martyrs' to find themselves in prison".

3. No-one was ever sent to prison as a consequence of offences or non-payment of finds under either Act.